

Delaware Department of Justice Announces Top Investor Threats

Promissory notes, real estate investments, and Ponzi schemes top the list

The Delaware Department of Justice released its annual list of top investor threats and reminded Delawareans to use caution when approached with any unsolicited investment opportunities. "All investments involve a degree of risk," said Attorney General Matt Denn. "Investors can help protect themselves by taking time to research both the investment product and the person selling it. It's best to learn before you get burned."

The top threats were determined by surveying members of the North American Securities Administrators Association, of which the Delaware Department of Justice is a member, to identify the most frequently identified source of current investor complaints or investigations.

The following were cited most often:

PROMISSORY NOTES: A promissory note is a written promise to pay (or repay) a specified sum of money at a stated time in the future or upon demand. Companies may sell promissory notes to raise capital, and usually offer them only to sophisticated or institutional investors. Promissory notes from legitimate issuers can provide reasonable investment returns at an acceptable level of risk, although state securities regulators have identified an unfortunately high number of promissory note frauds. Investors should be cautious about promissory notes with durations of nine months or less, as these notes

generally do not require federal or state securities registration.

REAL ESTATE INVESTMENTS: The promise of earning quick money through investments related to real estate continues to lure investors. Investors should be cautious about real estate investment seminars, especially those marketing real estate investments aggressively as an alternative to more traditional retirement planning strategies involving stocks, bonds and mutual funds. Two of the most popular current investment pitches at these seminars involve so-called “hard-money lending” and “property flipping.” Hard-money lending is a term used to refer to real estate investments financed through means other than traditional bank borrowing. Property flipping is the practice of purchasing distressed real estate, refurbishing it, and then immediately re-selling it in hopes of earning a profit. Property flipping financed through borrowed funds or outside investments can be done entirely lawfully, but it can also be a source for fraud.

PONZI/PYRAMID SCHEMES: A Ponzi scheme is a ploy wherein earlier investors are repaid through the funds deposited by subsequent investors. In a Ponzi scheme, the underlying investment claims are usually entirely fictional; very few, if any, actual physical assets or investments generally exist. As the number of total investors grows and the supply of potential new investors dwindles, there is not enough money to pay off promised returns and cover investors who try to cash out. Similarly, a pyramid scheme is a fraudulent multi-level marketing strategy whereby investors earn potential returns by recruiting more and more other investors. Multi-level marketing strategies are not intrinsically fraudulent, and there are many legitimate multi-level marketing companies offering various consumer products and services. What makes a multi-level marketing strategy into a fraudulent pyramid scheme is the lack of a genuine underlying investment enterprise or product upon which the strategy can hope to be

sustained.

OIL & GAS INVESTMENTS: Many oil and gas investment opportunities, while involving varying degrees of risks to the investor, are legitimate in their marketing and responsible in their operations. Because these ventures are so speculative, the potential for fraud is rife. Scammers may misrepresent the likelihood that an oil or gas well will be successful – or may not even ultimately drill a well at all. Fraudulent oil and gas schemes frequently take the form of Ponzi schemes, with investors' funds being "recycled" to keep the scheme going.

AFFINITY FRAUD: In an affinity fraud, a con artist uses some sort of connection with the victim as the basis for the fraud. Affinity frauds may involve people who attend the same church, belong to the same club or association, or share a common hobby. The con artist knows it is often easier for victims to trust someone who seems to be like them. Once a victim realizes that he or she has been scammed, too often the response is not to notify the authorities but instead to try (usually unsuccessfully) to solve problems within the group. Affinity fraud can not only be financially devastating to the victims, but often has the perverse effect of causing victims to lose trust in the group or affiliation that was previously a source of comfort or support. The psychological damage can be just as harmful as the financial damage.

VARIABLE ANNUITY SALES PRACTICES: Variable annuities are hybrid investments containing both securities and insurance features. While these products are entirely legitimate, they are not suitable for all investors. Senior investors, in particular, should beware of the high surrender fees and steep sales commissions agents often earn when they move investors into variable annuities. Investors should be especially wary of any broker who wants to sell a variable annuity to hold inside a qualified retirement plan, such as a 401(k) plan or Individual Retirement Account (IRA), as these types of retirement account will already benefit from tax deferment.

The Investor Protection Unit of the Delaware Department of Justice offers a wealth of free investor education materials and can help investors research the background of those selling or advising the purchase of an investment. The Investor Protection Unit can be reached at (302) 577-8424 or through its [website](#).